



**City of Detroit**

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**OFFICE OF  
THE AUDITOR GENERAL**

**Report on the Investigation of  
Allegations of Control Issues  
Within the Detroit Public Library**

**July 2002**




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## MEMORANDUM

**DATE:** October 30, 2002

**TO:** Mayor Kwame Kilpatrick  
Honorable City Council

**FROM:** Joseph L. Harris   
Auditor General

**RE:** Report on the Investigation of Allegations of Control Issues Within the  
Detroit Public Library

Attached for your review is our report on the investigation of allegations of control issues within the Detroit Public Library. The report was requested by the City Council to investigate the allegations made by the former Detroit Public Library Associate Director of Business and Financial Operations regarding improper financial management practices at the Detroit Public Library (DPL).

This report contains an executive summary; background; our audit objectives, scope, and methodology; and our findings and recommendations. We appreciate the cooperation of the employees and management of the DPL and the Friends of the Detroit Public Library, Inc. extended to us during the audit.

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**Table Of Contents**

Executive Summary	i
Background	1
Audit Objectives, Scope, and Methodology	3
Findings and Recommendations	
Finding 1: Two Accounting Systems and Poor Accounting and Financial Controls	8
Finding 2: Questionable Procurements and Disbursements	16
Finding 3: Duplicate Payments Made	22
Finding 4: Questionable Transactions Related to Former Director's Automobile	25
Finding 5: Personal Service Contractors Not Provided Form 1099-MISC	29
Finding 6: Computers Missing	30
Finding 7: Funds Not Spent in Accordance with Restrictive Agreements	32
Finding 8: Special Event Revenue Not Properly Accounted For	34
Finding 9: Inadequate Accounting for Donations from the Friends of the DPL	36
Finding 10: Lack of Accountable Plan for Employee Travel	39
Finding 11: Other Financial Considerations	41

## **EXECUTIVE SUMMARY**

### **INTRODUCTION**

On June 25, 2001, the City Council requested the Auditor General perform an investigation of the allegations made by the former Detroit Public Library Associate Director of Business and Financial Operations regarding improper financial management practices at the Detroit Public Library (DPL).

### **AUDIT PURPOSE**

The purpose of the investigation was to:

1. Investigate the allegations made by the former DPL Associate Director of Business and Financial Operations regarding improper financial management practices at the Detroit Public Library (DPL); and
2. Provide recommendations for improvements of the DPL management and the system of internal controls.

### **OVERALL CONCLUSION**

We have confirmed the validity of the majority of the former DPL Associate Director of Business and Financial Operations allegations regarding improper financial management practices at the Detroit Public Library (DPL). The DPL maintains two accounting systems: (1) funds under the custodianship of the City Treasurer and a budget approved by the City Council (City accounting system); and (2) funds under the custodianship of the DPL that were not included in the City accounting system nor in the City Council approved budget (DPL accounting system). In general, the DPL accounting system internal controls were so poor that an unacceptable and high risk existed for fraud, waste, and abuse. The DPL accounting system did not properly account for cash, investments, fixed assets, accounts payable, revenues, and expenditures. Planning and budgeting were not performed for operations funded by the DPL accounting system assets. Not all DPL accounting system funds were periodically audited. In addition, the DPL internal accounting control system for procurements and disbursements processed through the City's accounting system were also poor or circumvented.

We observed missing receipts, duplicate payments, unsupported payments, excessive payments, and missing computers that were the direct result of the poor internal controls. Procurements were made without following good procurement practices, such as competitive bidding. In some cases, the DPL Purchasing Department was not included in the process to procure major goods and services.

The deficiencies that we observed were partly due to the: (1) existence of two independent accounting systems; (2) lack of accountability; and (3) unsatisfactory financial management and circumvention of the system of internal controls under the leadership of the former DPL Director.

In our opinion, some of the questionable procurements and disbursements may be the result of gross negligence or fraud and should be investigated further by law enforcement officials.

The current DPL administration has initiated corrective action by creating written internal control procedures for all major financial functions and an action plan to improve internal controls. In addition, they have adopted the City of Detroit's travel policy (i.e., accountable

plan) and reimbursed the Burton Fund for improper expenditures for rare books. Also, they have hired a new Associate Director of Business and Financial Operations and he has begun to implement many of the recommendations in this report including contracting for an audit of the funds under the custody of the DPL. The current DPL administration is committed to improving the DPL's financial management.

### **Summary of Major Findings**

1. The DPL accounting system internal controls and financial management were unsatisfactory, creating a high risk for fraud, waste, and abuse.
2. The DPL internal controls for procurements and disbursements were unsatisfactory, resulting in excessive and questionable payments.
3. The DPL made three duplicate payments that we observed. The DPL recovered one of the three duplicate payments. However, the manner in which the payment was recovered is questionable, as the DPL procurement and disbursement internal controls were circumvented.
4. The purchase of an automobile in the name of the former Director and the subsequent transfer of the automobile to the DPL around the time of the allegations with no documentation of the exchange except for an incomplete certificate of title raise questions of possible improprieties concerning the vehicle.
5. The DPL did not provide Form 1099-MISC to all personal service contractors for 2001, as required by the United States Internal Revenue Service, which could subject the DPL to fines and penalties.
6. The DPL cannot account for at least 59 personal computers purchased in the last three years.
7. The DPL used some endowment funds for purposes other than those stipulated in the restrictive agreements and some funds received from restricted gifts, grants, and endowments were not utilized as intended and are accumulating in bank accounts.
8. The DPL did not properly account for special events in fiscal year 2000-2001.
9. The DPL lacks a formal agreement with the Friends of the Detroit Public Library establishing organizational responsibilities. Also, the DPL internal controls over supporting payments received from the Friends of the Detroit Public Library were weak.
10. The DPL did not properly account for travel funds, as required by the IRS.

### **Summary of Major Recommendations**

1. We recommend that the City Law Department review the applicable State laws and determine whether the DPL should have custody of the funds currently under the DPL control. In the meantime, we recommend that the DPL management take action to improve its internal control and financial management systems including developing a plan and budget for the funds presently in its custody.

2. We recommend that law enforcement officials investigate certain DPL procurements and disbursements for impropriety. In addition, we recommend that the DPL management take action to improve its internal controls over procurements and disbursements including requiring competitive bidding for all major contracts.
3. We recommend that the DPL management adopt sufficient internal controls to prevent duplicate payments and recover the duplicate payments that have been identified from the vendors.
4. We recommend that law enforcement officials investigate the procurement of the former Director's automobile and the transfer of the automobile to the DPL to determine whether any improprieties occurred.
5. We recommend that law enforcement officials investigate the missing computers to determine whether any theft or misappropriation occurred. Also, we recommend that the DPL establish adequate internal controls to safeguard fixed assets.
6. We recommend the DPL adopt accounting and quality control procedures to ensure all Form 1099-MISC are provided to vendors as required by the IRS.
7. We recommend that the DPL management develop a plan for the utilization of grants, gifts, and endowments in accordance with the restrictive agreements. Also, the DPL needs to establish controls to monitor the receipt and expenditure of grant, gift and endowment funds.
8. We recommend that the DPL management establish adequate controls over special events to include planning and budgeting.
9. We recommend that the DPL and the Friends of the Detroit Public Library enter into an agreement to clearly establish the mission and responsibilities for both organizations. In addition, we recommend that the DPL management improve internal controls over support provided by the Friends of the Detroit Public Library to include planning and accounting for all support.

## **BACKGROUND**

In two letters dated May 13, 2001 and June 16, 2001 to the Internal Revenue Service, the DPL former Associate Director of Business and Financial Operations provided details of violations by library employees of the United States Internal Revenue Service (IRS) Department's rules regarding travel expenses.

In two letters dated June 16, 2001 and June 17, 2001, to the City Council President Pro Tem, the former DPL Associate Director of Business and Financial Operations provided some broader allegations regarding improper financial management practices, including violations of IRS rules, at the DPL.

In June 2001, the Detroit Library Commission approved a request to engage Plante & Moran LLP to assess the major financial systems of the DPL and to make recommendations for improvements. This investigation included financial management, transaction processing, procurement, and human capital considerations. A copy of the completed report was submitted to the Detroit Library Commission and library administration in October 2001. The summary findings of the report are:

- The Library could benefit significantly by fully utilizing the existing processes and systems available from the City. This applies primarily to the accounting for General Fund items.
- Grant and trust fund accounting operations could be significantly enhanced through improved processes and upgraded financial systems technology.
- Business Office overall performance could be enhanced through the implementation of additional technology (i.e., DRMS Purchasing Module, independent accounting software, etc.) and comprehensive assessment of its network infrastructure.
- Library operations may be improved through the establishment of formal, written policies and procedures
- Oversight of library financial information could be enhanced through comprehensive budgeting and reporting at the department/branch level.

The following key recommendations related to fiscal management were included in the summary presentation handout:

- Implement detailed budgeting, tracking, and reporting of expenditures on a monthly basis to the department/branch level;
- Consider producing consolidated financial statements on a Library-wide basis;
- Consider additional methods of communicating the financial health of the Library to the Commission;
- Hire a permanent Finance Director to provide process improvement, implementation sponsorship, and ongoing fiscal leadership for the organization; and

- Implement the use of City of Detroit Budget Journal Entry Request forms to transfer funds between organization codes within appropriations.

In August 2001, The former Associate Director of Business and Financial Operations filed a lawsuit against the DPL, Detroit Library Association Commission, and City of Detroit in Wayne County Circuit Court. The lawsuit against the City of Detroit has been dropped. The former Associate Director of Business and Financial Operations alleges violation of whistleblower protections and violation of the public policy of the State of Michigan for terminating his employment on June 7, 2001 as a result of a refusal to participate in criminally fraudulent activity in violation of one or more state statutes. The outcome of this lawsuit is pending.

In December 2001, the former DPL Director took an extended leave of absence, due to medical reasons. In March 2002, the former DPL Director officially resigned his post. The Office of the Auditor General conducted this investigation with the assistance of the Acting DPL Director and other DPL employees.

The DPL is an independent, municipal corporation governed by a seven-member Detroit Library Commission, whose members are appointed by the Detroit Board of Education. No one body is responsible for funding the library. Its revenues come from resources that include money from the state equity grant, penal fines, the single business tax reimbursement, the city general fund (there have not been any general fund contributions in years), state aid, City of Detroit property taxes, gifts, grants, endowments, investment income, and special events.



## **AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY**

### **AUDIT OBJECTIVE**

#### **A. Overall**

To determine whether the allegations made by the former DPL Associate Director of Business and Financial Operations concerning financial improprieties at the DPL were valid.

#### **B. Specific**

1. Determine the legal jurisdiction over the DPL operations (i.e., State, City, combination) and the internal controls and accounting procedures required.
2. Determine the DPL procedures and methods, which comprise the DPL accounting system (e.g., revenue accounting, purchases, accounts payable, and cash disbursements).
3. Determine whether the DPL revenues and receipts including gifts, endowments, grants and any other restricted or unrestricted revenues were properly accounted for.
4. Determine whether the DPL purchases were proper and controlled (e.g., purchase orders issued).
5. Determine whether all DPL disbursements including disbursements from gifts, endowments, grants, and any other restricted or unrestricted funds were properly accounted for.
6. Determine whether contractors were paid more than once for the same service (i.e., duplicate payments).
7. Determine whether the former Director of the DPL was authorized a vehicle and insurance paid for by the DPL.
8. Determine whether disbursements by the DPL for personal services (e.g., artistic performances, consulting) were properly reported to the IRS (i.e., IRS Form 1099-MISC).
9. Determine whether the DPL fixed assets, including computer equipment, were properly accounted for and controlled (e.g., tagged).
10. Determine whether all the DPL endowment and grant funds were being audited annually or in accordance with endowment and grant agreements.
11. Determine whether revenues and expenditures for special events managed by the DPL were properly accounted for.
12. Determine whether direct grants made by the Friends of the Detroit Public Library to the branch Library managers and other DPL personnel were proper and accounted for.

13. Determine whether DPL travel/training disbursements were proper and controlled (e.g., policies and procedures exist).

### **SCOPE AND METHODOLOGY OF INDEPENDENT INVESTIGATION**

We reviewed the aforementioned letters and an article in The Michigan Citizen newspaper (October 27, 2001) to identify the key investigative issues, as a basis for determining the nature and extent of our investigation procedures. To conduct the actual investigation, we performed the following procedures:

- Examined contract documents and other evidentiary matter as a basis for data gathering regarding the major allegations referenced in the letters and newspaper article;
- Conducted a series of interviews with representatives from the DPL, Friends of the Detroit Public Library, and accounting consultants retained by the DPL (based upon the litigation-in-process, we did not interview the former DPL Associate Director of Business and Financial Operations during the course of the investigation); and
- Conducted verification and follow-up procedures regarding information provided during interviews.

Based upon some indicators of possible financial misconduct discovered during the independent investigation, we decided to refer further investigation of some of the former DPL Associate Director of Business and Financial Operations' allegations to law enforcement officials. The indicators of possible financial misconduct discovered by us were sufficient to warrant further investigation. To protect the integrity of any future investigations by law enforcement officials, we decided not to interview the former DPL Director.

### **ALLEGATIONS AND OTHER FINANCIAL MANAGEMENT ISSUES**

During our fieldwork, some additional issues and concerns, not detailed in the former DPL Associate Director of Business and Financial Operations letters were discovered. Therefore, our investigation addresses the allegations documented in the letters and newspaper article and other financial management issues that surfaced during the fieldwork phase of the investigation. For purposes of our independent investigation, we categorized the allegations and financial management issues into the following major examination areas:

1. Analyzing cash balances for evidence of misappropriation;
2. Protecting the financial interests of the DPL in contracts with professional service providers;
3. Accounting, financial reporting, and auditing considerations for the DPL arising from the maintenance of two separate accounting systems;
4. Accounting, financial reporting, and auditing considerations for individual DPL gift, grant, and endowment agreements;
5. Library policies and procedures governing the movement of funds among various bank accounts;
6. Library policies and procedures governing the utilization of specific cash accounts for designated business purposes;

7. Existence of an accountable plan for travel, entertainment, gift, and car expenses;
8. Circumstances surrounding the purchase and subsequent transfer of ownership of a library vehicle from a library official to the library;
9. Library policies and procedures to report Form 1099-MISC for personal service contractors;
10. Adequacy of internal controls to provide reasonable assurance that cash disbursements reflect *bona fide* expenditures;
11. Adequacy of internal controls to provide reasonable assurance that goods and services are procured in accordance with generally accepted principles of public contracting; and
12. Adequacy of internal controls to provide reasonable assurance that fixed assets are safeguarded.

## **FRAMEWORK OF THE INDEPENDENT EVALUATION**

The following authoritative statutes and documents guided our investigation:

### **1. Various State of Michigan Public and Local Acts**

State of Michigan Public Act 26 of 1921 addresses the jurisdiction (i.e., City and DPL), annual budget, fiscal year, payrolls, bills, accounts, claims, disbursements, and approvals; for library commissions in cities having a population of more than 250,000 people. Public Act 26 of 1921, Section 2, requires "The annual budget of any said commission shall be prepared in manner and time provided by the charter of any said city concerning the budget thereof and shall be submitted to and passed upon by the officers and boards of any said city as are the items in the budget thereof." Public Act 26 of 1921, Section 5, requires "All payrolls, bills, accounts and claims of every character against the library commission after having been duly audited and approved by the commission, the certificate of which audit and approval shall be endorsed thereon by the president or secretary of the commission or some member or other representative of the commission acting under authority conferred by the commission generally or specifically, shall be transmitted to the city controller, who shall endorse thereon his approval or disapproval. When so endorsed with approval the controller shall draw his warrant or warrants on the city treasurer in payment therefor. No bill, account or claim shall be audited or approved by the commission unless the same shall be accompanied by a certificate of a representative of the commission who acted for the commission in making the purchase or contract or in taking the delivery or performance that he verily believes the services or property therein charged have been actually performed or delivered for the commission, that the sum or sums charged therefor are reasonable and just, and that to the best of his knowledge and belief no setoff exists, nor payment has been made on account thereof except such as are included or referred to in such account."

State of Michigan Local Act 359 of 1901, as amended by Local Act 390 of 1903, specifies, "No contract entered into by said commission shall be valid until there shall have been endorsed thereon the certificate of the controller [City] that the money proposed to be expended thereunder is in the treasury of said city or that an appropriation has been made therefor."

State of Michigan Local Act 359 of 1901, Section 3, as amended by Local Act 460 of 1905 requires the DPL provide to the City Council for approval an annual budget for all revenues and expenses for the proper maintenance of the public library. Specifically it states, "It shall be the duty of the Detroit Library Commission to transmit to the common council through the city controller, an estimate [Budget] of the amount of money which said commission may deem necessary for the proper maintenance of the public libraries of the city of Detroit, during the fiscal year next ensuing, which estimate shall, as far as practical, be made in detail, specifying the amounts required for books, magazines and other publications, for salaries of employees, repairs, new buildings, additions to library buildings, fuel, supplies, and general current expenses, together with an estimate of the revenues to be derived during the fiscal year next ensuing, from sources other than taxation. So much of the said estimate as the common council and the board of estimates of the city of Detroit shall approve shall be levied and collected the same as other city taxes of said city: Provided, however, that the amount so approved, together with the revenues to be derived from other sources than taxation, except gifts, grants, devises, bequests, fines for breach of the penal laws of the State and funds from other public sources, shall not be less than one-fifth of a mill on the dollar on property assessed for city purposes. It shall be unlawful for the said Detroit Library Commission to pay out or agree to pay out any money for any item or items or for any object or objects disallowed by the said common council or board of estimates [Budget Department]: Provided, however, that in case of any loss, by fire or otherwise, to the property of the said commission, or in case it shall be necessary for the Detroit Library Commission to acquire additional funds in order to comply with the terms of any proposed gift to said commission, or in any case of any unforeseen contingencies, for which no appropriation shall have been made, the common council may authorize the commission to provide the necessary moneys for the same from any available funds of said commission, or may authorize the controller of the city of Detroit to borrow the same on the faith and credit of the city; but no such amount for any specific purpose in excess of two thousand five hundred dollars shall be authorized, unless the same shall have been approved by the board of estimates at a meeting called for that purpose."

## **2. Travel, Entertainment, Gift, and Car Expenses (Internal Revenue Service Publication 463)**

The publication explains what travel expenses are deductible, how to report them on the individual tax return, what records are needed to prove travel expenses, and tax treatment of expense reimbursements received by the employee.

## **3. City of Detroit Budget Directive 01-2; Employee Travel Procedures**

The purpose of this Directive is to provide guidelines and specific procedures for the expenditure and reimbursement of funds used for travel by City of Detroit employees. The goal of the policy is to accomplish travel deemed important by agency directors in a cost-effective and expeditious manner.

## **4. Detroit Library Commission Proceedings**

The official minutes of the Detroit Library Commission record the formal activities and actions of the board.

## **STATEMENT ON GOVERNMENT AUDITING STANDARDS**

Although this independent investigation is not characterized as an audit, to the extent practicable, and where possible, we performed our investigative procedures in accordance with generally accepted government auditing standards.

### **PRIVILEGED AND CONFIDENTIAL INFORMATION DISCLOSURE**

*Government Auditing Standard No. 7.47* states, “If certain information is prohibited from general disclosure, auditors should report the nature of the information omitted and the requirement that makes the omission necessary.” This report omits some information, including the identities of certain individuals and business firms, which, from an audit viewpoint, are considered privileged and confidential.

### **ISSUES NEEDING FURTHER STUDY**

*Government Auditing Standard No. 7.50* specifies that audit reports should include a listing of any significant issues needing further study and consideration. The auditors should disclose the issues in the report and the reasons the issues need further study. In our opinion, a performance audit of the DPL should be conducted. This assessment is based upon our observations made during the independent investigation, in relation to opportunities to improve library processes. The performance audit should include benchmarking of DPL organization, operations, accounting system, and fundraising with other comparable library systems in the country.

## **FINDINGS AND RECOMMENDATIONS**

### **1. Two Accounting Systems and Poor Accounting and Financial Controls**

#### **Allegation**

The former DPL Associate Director of Business and Financial Operations made the following allegations concerning two accounting systems and poor accounting and financial controls at the DPL:

- "Now, the Library has held its many grants and gifts in off-book accounts for several years. Needless to say, these accounts are not audited. I am dealing with that illegality through other means."
- "Subsequently, I unilaterally ceased the making of any expenditures from any off-book account. The Executive Management declares that it is independent from the City of Detroit, both financially and otherwise. Act 26 of 1921, a statute of the State of Michigan, indicates otherwise."
- "There is no control over expenditures from the second set of books and no reporting on the funds contained in the second set of books."
- "Most of the problems are with the setup of the library accounting system."
- "These funds are illegally hidden from the public. The money is not included in DPL's public financial statements, although by law it is supposed to be. Placed in hidden bank accounts, these funds are spent without oversight by the Library Commission, City Council, citizens or library patrons."
- "One such hidden account is the DPL's "gift checking" bank account. Many donations and grants are put into this account, which library officials use for expenditures, often without documentation."
- "Library records show nine other accounts holding grant funds from foundations, such as the Burton Endowment Fund, the McGraw Memorial Fund and the John J. O'Brien Fund. And like the gift checking account, these funds are kept out of the public record, and are disbursed with inconsistent or nonexistent documentation."

#### **OAG Conclusion**

1. The DPL does maintain two separate and distinct accounting systems for its financial operations. The first accounting system (City accounting system) includes funds under the custodianship of the City Treasurer and includes a budget approved by the City Council. The second accounting system (DPL accounting system) includes funds under the custody of the DPL that are not included in the City accounting system nor in the City Council approved budget.
2. In our opinion, based on the requirements of state law, (State of Michigan Public Act 26 of 1921 and State Local Act 359 of 1901, as amended by Local Act 390 of 1903, and amended by Local Act 460 of 1905) and the weak DPL system of internal accounting controls, which have resulted in losses to the DPL, the DPL should not have custody of any funds and should deposit all the funds in its custody (i.e., all non-City of Detroit accounts) with the City of Detroit Treasury. In addition, the DPL should include the revenues and expenses expected for these funds with the annual budget prepared for the City of Detroit.

3. The DPL system of internal accounting controls contained such material weaknesses that the assets in the custody of the DPL were at a high risk for fraud, waste, and abuse. In addition, the existence of two accounting systems further increased the risk. Also, a major contributing factor is that the DPL is an independent municipal corporation and the City cannot legally exert controls and accountability over the DPL other than those allowed by State law, as detailed below.
4. A key issue facing DPL and City of Detroit officials is "What entity should maintain custody of the funds in the DPL accounting system?" The DPL and the City differ on this issue and the legal arguments are based on antiquated State laws. Good accounting practice requires that all funds be under the custody of a single entity with an adequate system of internal controls to properly safeguard them. In addition, good accounting practices require a comprehensive accounting and budgeting system be utilized by the DPL.
5. The current DPL administration has initiated corrective action by creating written internal control procedures for all major financial functions and an action plan to improve internal controls. In addition, they have hired a new Associate Director of Business and Financial Operations and he has begun to implement many of the recommendations in this report including contracting for an audit of the funds under the custody of the DPL. They are committed to improving the DPL's financial management. However, as detailed below they have much work to do.

## **Background**

### **A. Independent Auditor's Perspective (1960s)**

In the late 1960s, the external auditors, Lybrand, Ross Bros. & Montgomery, noted that many accounts including the "gift fund", Burton endowment, McGraw Memorial fund and other trust funds were not recorded in the Library Fund (City) accounting records maintained by the Controller's Office (Finance Department). It stated "these funds are controlled and administered by the Library Commission, and the expenditure of these funds for the specified library purposes are not under the financial and budgetary controls of the City. We understand that there is presently some disagreement between the City and the Library Commission as to the custody of the funds. Regardless of the final decision as to custody of the funds, we believe that it would be desirable for the balances and activity in these funds to be recorded in separate accounts in the library Fund, so that the financial statements of the Library Fund will reflect all amounts applicable to Library operations. We therefore recommend that procedures be established to provide for the reporting of these amounts by the Library Commission to the Controller's Office, and the recording of these amounts in the Library Fund by the Controller's Office." As of July 31, 2002, the DPL has not fully adopted this recommendation.

### **B. Various City of Detroit Administrators' Opinions (1964)**

A letter to the Library Director from the Auditor General, dated July 30, 1964, stated, "As you know, your department's handling of several large cash gifts received for furnishings and other purposes in connection with the Main Library Addition has been a subject of disagreement for more than two years. Several legal opinions have been issued by the Corporation Counsel's Office stating, either directly or by implication, that such monies should be expended only after having been appropriated by the Common

Council. It has been the position of the City Controller, in which we concur, that this recommended procedure would require that the gift money be deposited with the City Treasurer, and that the expenditures be processed in the same manner as other disbursements for Library purposes.

'Your Commission has not complied with the recommended procedure, and gift funds have been disbursed solely on the authority of the Commission.'(Emphasis added).

As of July 31, 2002, the DPL does not deposit all the funds it receives with the City Treasurer. In addition, the City Council approved budget for the DPL does not contain appropriations for all of the DPL expenditures, specifically those made from the DPL accounting system.

### **C. Internal Auditor's Perspective (1970s)**

In the early 1970s, the OAG noted in the Library workpapers under "Possible Internal Control Weaknesses", 12 separate funds (accounting entities), not including the City Library Fund, having 14 checking accounts and 3 separate savings accounts maintained by the Library for various purposes. The auditor stated, "Because of the number of funds and amounts of money involved, especially the lack of a comprehensive audit, including all funds, the lack of audits for each and every fund, and the accessibility of the same individuals to all of the funds, the possibility of avoiding disclosure of misuse of funds, etc. can be accomplished quite easily with relatively small amounts (\$1,000 or less).

'Although the sources of these funds appear to be private individuals and organizations, since the books of these funds are maintained by the Library employees and since these funds are used for Library purposes, we should recommend that the Library report transactions and balances of these funds to the Common Council annually, so that Common Council can make appropriate allocation of City funds, by sources of total funds available to the Library. The accounting principle of full disclosure will be adhered to in the process of reporting total activity of all funds to Common Council."

This finding on the DPL is still valid today.

### **D. Independent Auditor's Perspective (1980)**

In a footnote disclosure regarding the Library Fund in the City of Detroit Comprehensive Annual Financial Report (1980), the external auditors stated, "The DPL is administered by the Detroit Library Commission, a separate municipal corporation existing by virtue of State Law. Under the law, the budgetary transactions of the Detroit Public Library are subject to the same financial control as if it were a City Department.

'There are other funds administered by the Library Commission that are not under the budgetary and financial control of the City, therefore, they are not reflected in the accompanying financial statements."

### **E. Basis in the Law**

In our opinion, based on the State of Michigan laws, the DPL is required to deposit all funds received for the Library in the City Treasury and provide to the City Council for approval an annual budget for all revenues and expenses for the maintenance of the DPL. The State law requires that all payments made for the DPL must be approved by the City of Detroit, Finance Department, and that all checks be drawn on the City of



Detroit, Treasury's Library Fund bank account. In addition, the State law requires that the DPL provide to the City Council for approval an annual budget of all revenues and expenses for the proper maintenance of the DPL.

State of Michigan Public Act 26 of 1921, as amended by Public Act 220 of 1967, establishes the Detroit Library Commission (DPL) jurisdiction and provides requirements for the annual budget and disbursements. Public Act 26 of 1921, Section 2, requires "The annual budget of any said commission shall be prepared in manner and time provided by the charter of any said city concerning the budget thereof and shall be submitted to and passed upon by the officers and boards of any said city as are the items in the budget thereof." Public Act 26 of 1921, Section 5, requires "All payrolls, bills, accounts and claims of every character against the library commission after having been duly audited and approved by the commission, the certificate of which audit and approval shall be endorsed thereon by the president or secretary of the commission or some member or other representative of the commission acting under authority conferred by the commission generally or specifically, shall be transmitted to the city controller, who shall endorse thereon his approval or disapproval. When so endorsed with approval the controller shall draw his warrant or warrants on the city treasurer in payment therefor. No bill, account or claim shall be audited or approved by the commission unless the same shall be accompanied by a certificate of a representative of the commission who acted for the commission in making the purchase or contract or in taking the delivery or performance that he verily believes the services or property therein charged have been actually performed or delivered for the commission, that the sum or sums charged therefor are reasonable and just, and that to the best of his knowledge and belief no setoff exists, nor payment has been made on account thereof except such as are included or referred to in such account."(Emphasis added).

State of Michigan Local Act 359 of 1901, as amended by Local Act 390 of 1903 specifies, "No contract entered into by said commission shall be valid until there shall have been endorsed thereon the certificate of the controller [City] that the money proposed to be expended thereunder is in the treasury of said city or that an appropriation has been made therefor."(Emphasis added).

State of Michigan Local Act 359 of 1901, Section 3, as amended by Local Act 460 of 1905, requires the DPL provide to the City Council for approval an annual budget for all revenues and expenses for the proper maintenance of the public library. Specifically it states, "It shall be the duty of the Detroit Library Commission to transmit to the common council through the city controller, an estimate [Budget] of the amount of money which said commission may deem necessary for the proper maintenance of the public libraries of the city of Detroit, during the fiscal year next ensuing,....which estimate shall, as far as practical, be made in detail, specifying the amounts required for books, magazines and other publications, for salaries of employees, repairs, new buildings, additions to library buildings, fuel, supplies, and general current expenses, together with an estimate of the revenues to be derived during the fiscal year next ensuing, from sources other than taxation. So much of the said estimate as the common council and the board of estimates of the city of Detroit shall approve shall be levied and collected the same as other city taxes of said city: Provided, however, that the amount so approved, together with the revenues to be derived from other sources than taxation, except gifts, grants, devises, bequests, fines for breach of the penal laws of the State and funds from other public sources, shall not be less than one-fifth of a mill on the dollar on property assessed for city purposes. It shall be unlawful for the said Detroit Library Commission

to pay out or agree to pay out any money for any item or items or for any object or objects disallowed by the said common council or board of estimates [Budget Department]: Provided, however, that in case of any loss, by fire or otherwise, to the property of the said commission, or in case it shall be necessary for the Detroit Library Commission to acquire additional funds in order to comply with the terms of any proposed gift to said commission, or in any case of any unforeseen contingencies, for which no appropriation shall have been made, the common council may authorize the commission to provide the necessary moneys for the same from any available funds of said commission, or may authorize the controller of the city of Detroit to borrow the same on the faith and credit of the city; but no such amount for any specific purpose in excess of two thousand five hundred dollars shall be authorized, unless the same shall have been approved by the board of estimates at a meeting called for that purpose. ..." (Emphasis added).

#### **F. Responsibilities of the Library Administration**

The DPL administrators are responsible for maintaining an adequate system of internal controls to safeguard DPL assets and ensure efficient and effective operations. The DPL administrators are also responsible for establishing and maintaining sound financial management practices to maximize investment income and safeguard cash assets.

#### **G. Cash and Investments and Related Income under Custody of the City of Detroit**

The City budget for the DPL was \$40.5 million in fiscal year 2000-2001, which does not include revenues (\$1,869,000) and expenses (\$1,231,000) for fiscal year 2000-2001 generated under the DPL accounting system.

#### **H. Cash and Investments and Related Income under Custody of the DPL**

The DPL accounting system reported \$10.6 million in cash and investments held in 32 different bank accounts including \$2.7 million in 4 endowment accounts, which the DPL had no control over the endowment corpus, but benefited from income distributions, at June 30, 2001. In addition, the DPL was a beneficiary of income from two other endowments totaling \$2.5 million that were not included in the \$10.6 million. At June 30, 2001, DPL had custodianship and control of over \$7.9 million in 28 different bank accounts. The DPL accounting system reported \$638,000 in net income for the fiscal year ended June 30, 2001.

#### **I. Enterprise-Wide Financial Statements**

The DPL reported the funds under its custodianship, along with most of the endowment assets, in the City of Detroit 2000-2001 CAFR (Comprehensive Annual Financial Report) for the first time. This was prompted by the City auditors to include all DPL funds in the CAFR.

The accuracy of some amounts reported in the CAFR for the fiscal year ended June 30, 2001, was questionable. For example, the June 30, 2001 bank reconciliations for the three major checking accounts controlled by the DPL contained errors, resulting in inaccurate cash balances. In our opinion, because of the weak nature of the system of internal controls and the errors in the bank reconciliations, the risk of a material misstatement in the DPL financial statements was high. We noted many internal control weaknesses and errors in the DPL accounting system. Some of these internal control weaknesses are described below.

### **Internal Controls and Other Issues**

The DPL accounting system of internal controls was weak. We noted the following internal control deficiencies and concerns for the DPL accounting system:

- Budgets were not prepared for the funds controlled by the DPL.
- Annual audits were not conducted for the majority of the funds controlled by the DPL (except the Detroit Associated Libraries and Burton endowment funds).
- Periodic financial statements were not prepared for the DPL funds.
- Some revenues and expenditures were not posted in the general ledger. For example, the investment income earned on some endowment assets and some expenditures incurred to renovate the Downtown Branch Library were not posted to the general ledger. As a result, the DPL trial balance and profit and loss statements for the periods ended June 30, 2001 and December 31, 2001 were inaccurate.
- Some DPL funds (i.e., Skillman, Gift Trust, O'Brien trust, and other trust accounts) were not included in the general ledger. As a result, we question the completeness of the financial representations made in the trial balance and financial statements for June 30, 2001 and December 31, 2001.
- The DPL general ledger was not reconciled to supporting subsidiary records or ledgers.
- The DPL did not designate a business purpose for each DPL accounting fund and bank account (e.g., travel checks were paid out of 3 different bank accounts).
- The DPL bank account reconciliations contained errors and possible irregularities (e.g., revenues deposited in prior periods were shown as reconciling items and voided checks were shown as outstanding checks).
- The DPL had weak procurement and disbursement internal controls (e.g., competitive bids were not sought for personal service contracts and some large construction projects) resulting in excessive and questionable disbursements (see Finding #2).
- The DPL had a weak system of internal controls to safeguard fixed assets, and a significant number of computers purchased by the DPL were missing from the inventory records (see Finding #6).
- The DPL management had not established internal controls for incoming receipts (e.g., a mail log was not maintained and cash receipts journal entries were not always posted to the general ledger).
- The DPL pre-numbered receipts were not reconciled to ensure all receipts including issued and non-issued pre-numbered receipts were accounted for.
- The DPL employees could not provide copies of the pre-numbered receipt forms for the Holiday Dinner and garage sale held in 2000, and the actual cash receipts may not have been properly accounted for.

- Some of the DPL Holiday Dinner receipts (\$6,348) were unaccounted for.
- The DPL could not provide deposit information for \$700 in rental and gift income and these cash receipts could be missing.
- The DPL accounting duties were not properly segregated among employees. The responsibility for writing checks, making bank deposits, and performing bank reconciliations was assigned to one employee. This employee also had signature authority for most of the bank accounts.
- The DPL purchasing duties were not properly segregated. The Purchasing Department employees procured fixed assets, tagged assets, and were responsible for the annual fixed asset inventory.
- The DPL Grants Coordinator arranged an Electronic Funds Transfer for a \$10,000 grant (National Endowment for the Arts) that he generated and controlled. We could not find the \$10,000 grant in the DPL general ledger, but it was properly deposited in a DPL bank account. This was too much control for one person and created a high risk for fraud.
- The DPL employees did not provide us with copies of some bank statements, such as the gift checking and O'Brien trust accounts. We requested the June 30, 2001 gift checking account bank statement many times, but the DPL accounting staff did not provide it to us. We noted many errors with the bank reconciliation for the gift checking account. This was significant because errors in bank reconciliations may conceal inappropriate use of funds. Also, we needed the bank statement to verify deposits and checks cleared, which we could not do.

The DPL accounting system of internal controls contained serious weaknesses that placed the funds at high risk for fraud, waste, and abuse. We noted missing receipts, duplicate payments, excessive payments, unsupported payments, and missing computers that were a direct result of the weak system of internal controls. In our opinion, some of the questionable procurements and disbursements were the result of either gross negligence or fraud.

#### **Assessment of Financial Management**

The DPL financial management of the funds in its custody was poor. We noted the following weaknesses:

- The DPL had an excessive number of bank accounts (35) including the City of Detroit controlled account. The DPL needs to eliminate many of these bank accounts, such as the Gift checking account, that was originally established to hold interest income for the Butzel donation. The project was completed over 25 years ago, but the funds (\$120,418 as of March 31, 2002) sit idle accumulating 1.35% interest per year.
- The DPL accountants did not always perform bank reconciliations, some were not done timely, and some were not done correctly. As noted previously, the June 30, 2001 bank reconciliations for the 3 major DPL controlled bank accounts had significant errors.
- The DPL had a large accumulation of funds in 11 checking accounts (\$1.5 million on June 30, 2001).

- The DPL lacked an investment strategy to maximize earnings from its cash assets.
- The DPL investment income was not always posted to the general ledger.
- The DPL was charged service charges on some bank accounts, and reported \$23,376 paid in fiscal year 2000-2001. The balance in the DPL Skillman checking account was being depleted by service charges.
- The DPL was not utilizing available funds adequately.
- The DPL deposited the \$73,554 in receipts from the sale of the Campbell Branch Library property in the DPL accounting system (Detroit Library Commission-Non City of Detroit bank account) for the fiscal year ended June 30, 2001. Based on documentation provided by the current DPL Associate Director of Business and Financial Operations, it appears that the Campbell Branch Library property was erected or renovated in 1920-21 for the purpose of a branch library with funds appropriated by the City of Detroit. Consequently, any receipts from the sale should have been deposited in the City of Detroit Treasury bank account for the DPL and included in the DPL's budget for fiscal year 2000-2001.
- The former DPL Director still had signature authority for some bank accounts, including the \$2.6 million O'Brien Fund trust account, as of March 31, 2002.

The poor accounting and reporting of funds resulted in management not being aware of funds available for operations. As a result, funds, especially donated funds, were not spent as intended (see Finding #7).

### **Recommendations**

1. We recommend the City Law Department review the applicable State laws and determine whether the City or DPL should have custody of the funds currently in the custody of the DPL. In addition, the City Law Department needs to determine the DPL's responsibility for including in the City Council approved budget the revenues and expenses accounted for in the DPL accounting system.
2. In the intervening period while custody issues are settled, we recommend the DPL take steps to improve its accounting and financial management internal controls for funds in its custody. A first step would be to create a budget for the funds in DPL custody and control. Periodic (e.g., monthly) financial statements should be prepared. The general ledger needs to be reconciled to subsidiary records such as the bank reconciliations. Good procurement practices, to include competitive bidding and detailed contracts protecting DPL interests, need to be implemented. The funds under DPL custody should be subjected to an annual independent audit.
3. We recommend minimization and consolidation of the DPL bank accounts. In our opinion, the number of bank accounts maintained by the DPL is excessive. We suggest implementation of the following basic system of bank accounts:
  - One checking account;
  - Individual trust (endowment) accounts as required by donor stipulations (e.g., Burton Fund);
  - One investment account; and

- Individual accounts as required by restrictive agreements (e.g., Skillman Foundation grant to renovate the Downtown Library Branch).
4. We recommend that the DPL management develop and implement a consolidated cash management strategy and an investment strategy. For example, we suggest implementation of the following cash management practices:
    - The funds in the O'Brien and Gift trust accounts (combined totaling approximately \$3.3 million market value at March 31, 2002) should be combined and utilized, as the DPL has full control over them.
    - The funds in checking account(s) should be swept into an investment account to maximize interest, on a daily basis.
  5. We recommend that the receipts from the sale of the Campbell Branch Library property be deposited with the City of Detroit Treasury bank account for the DPL and that the City's Budget Appropriations and Revenues for the DPL in fiscal year ending June 30, 2003 be increased by \$73,554 each.

## **2. Questionable Procurements and Disbursements**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations made the following allegations regarding questionable procurements and disbursements by the DPL:

- "Library funds are often spent without contracts, invoices, or other documentation."
- "Funds are spent without oversight by the Library Commission, City Council, citizens or library patrons."
- "One such hidden account is the DPL's "gift checking" bank account. Many donations and grants are put into this account, which library officials use for expenditures, often without documentation. From these funds, the library has paid out on lucrative service contracts without competitive bidding. From these funds, library personnel have taken thousands of dollars for various purposes without submitting receipts."
- "These funds are kept out of the public record and are disbursed with inconsistent or nonexistent documentation."
- "In one example, the Library paid \$19 million for repairs after a fire [Public Lighting Department transformer explosion in the Main Library in September 2000] and flood [July 2000] at the Main Library in June 2000. The payout was made with no contract between DPL and [the contractor - name omitted]. The Accounting Department was being instructed to pay millions of dollars with no documentation. The Library issued a confirming purchase order only after the work was done. DPL's insurance company estimated the repairs at only \$5

million, eventually reimbursing the library \$9 million-less than half of what was actually spent."

### **OAG Conclusion**

The DPL's financial management and system of internal controls over procurements and disbursements were unsatisfactory. In addition, there is a possibility that fraud may have been committed in some of the questionable procurements and disbursements where the system of internal controls was circumvented or unsatisfactory.

We did observe that some DPL funds were spent without formal contracts, invoices, or other supporting documentation. The DPL procurement process had many internal control weaknesses that are described below. Competitive bidding was not always used to select suppliers, and some large contracts were awarded on a sole source basis. As a result, the DPL incurred excessive and questionable costs for some goods and services received.

The DPL paid \$16.6 million and owed another \$3.7 million for damage repairs (total of \$20.3 million invoiced) after a flood at the DPL caused by a sewer backup in July 2000 and a fire caused by the Public Lighting Department (PLD) transformer explosion in September 2000. However, we verified that there was no contract between the DPL and the General contractor. The DPL made many payments without proper support for the invoices. During an interview, a Purchasing Department representative stated that the former DPL Director ordered the DPL Purchasing Department employees to "pay them [repair invoices] period".

The DPL presumed that the costs for the flood and fire damage repairs would be fully covered (less a deductible) by insurance, but the DPL insurance vendor refused to reimburse more than \$9 million for the flood and fire damage repairs because: (1) the costs charged by the general contractor were excessive; (2) some invoices lacked supporting documentation; and (3) according to the insurance vendor the policy did not cover damage from pollutants such as E. coli bacteria contamination. The general contractor is currently suing the DPL for the \$3.7 million in unpaid invoices. As of this report date, the DPL is negotiating with the insurance company for full payment of the damage claims. The net cost to the DPL could total over \$11 million (not including administration and legal costs) for the flood and fire damage repairs if a settlement with the insurance vendor is not made.

### **Background**

#### **Basis in Law for DPL Disbursements**

State of Michigan Public Act 26 of 1921, Section 5, requires "All payrolls, bills, accounts and claims of every character against the library commission after having been duly audited and approved by the commission, the certificate of which audit and approval shall be endorsed thereon by the president or secretary of the commission or some member or other representative of the commission acting under authority conferred by the commission generally or specifically, shall be transmitted to the city controller, who shall endorse thereon his approval or disapproval. When so endorsed with approval the controller shall draw his warrant or warrants on the city treasurer in payment therefor. No bill, account or claim shall be audited or approved by the commission unless the same shall be accompanied by a certificate of a representative of the commission who acted for the commission in making the purchase or contract or in taking the delivery or performance that he verily believes the services or property therein charged have been actually performed or delivered for the commission, that the sum or sums charged therefor are reasonable and just, and that to the best of his

knowledge and belief no setoff exists, nor payment has been made on account thereof except such as are included or referred to in such account."(Emphasis added).

State of Michigan Local Act 359 of 1901, as amended by Local Act 390 of 1903 specifies, " No contract entered into by said commission shall be valid until there shall have been endorsed thereon the certificate of the controller [City] that the money proposed to be expended thereunder is in the treasury of said city or that an appropriation has been made therefor."

### **Control Over Procurement and Disbursements**

Since the DPL is organizationally independent from the City, it is not required to follow the City's procurement process. However, DPL management has a responsibility to implement a system of internal controls to provide reasonable assurance that objectives related to procurement are achieved, including adherence to sound public contracting practices, such as competitive bidding. In addition, DPL contract agreements should reflect the interests of the DPL to include a detailed description of goods and services to be delivered, rates and amounts to be charged for goods and services purchased, and other provisions (i.e., standard boiler plate) to adequately protect the DPL interests in procurement transactions.

### **Internal Controls and Other Issues**

During our investigation of the allegations, we noted the following internal control weaknesses and other related issues for procurement, disbursements, and the flood and fire damage repairs:

#### **Procurement**

- The DPL lacked an action/contingency plan for emergency procurements.
- The DPL lacked adequate planning for major purchases.
- In some cases, the DPL did not engage in competitive bidding for personal service contracts (e.g., public relations, accounting/consulting, and information technology consulting) and large projects (e.g., flood and fire damage repairs and downtown branch Library renovation).
- The DPL Purchasing Department was not involved in certain procurements.
- The renovations for the Downtown branch Library were budgeted at \$6.5 million. Competitive bids were not sought. The vendor developed the contract agreed to by the DPL. The DPL attorney reviewed the contract, but many of the recommendations for changes to the contract were not made by the DPL. One recommended change not made was to include provisions for the City DBE (Detroit Business Enterprise) and Executive Order 22 requirements. As of January 29, 2002, the cost estimate for this project was \$7.6 million, up \$1.1 million from the original \$6.5 million budget, even though the major work had not begun.
- The DPL did not have access to the City's Oracle Purchasing module. As a result, the City processed DPL invoices without assurance that purchases were proper and in accordance with good procurement practices.
- According to a DPL representative, the DPL Facilities Manager initiated some procurement transactions without obtaining proper approvals.



- The consulting agreement and purchase order for information technology consulting services lacked: (1) mark-up allowed for equipment procured by the contractor; (2) fees to be charged; (3) hours to be worked; (4) and termination date. The consulting agreement was signed by the former DPL Director and several invoices were processed prior to approval of the agreement by the Detroit Library Commission.
- The DPL needs to properly segregate procurement and disbursement duties, as too much control by one person may result in fraudulent payments. For example, the DPL Facilities manager initiated some procurement transactions, approved subcontractors, monitored services, and received and approved invoices for payment. Also, the former DPL Director initiated some procurement transactions, monitored services, received invoices, approved invoices, and the DPL Business office forwarded several check payments to his office for distribution to the vendor.
- Some DPL requisitions were made after the invoice dates. Some purchase orders were not created and proper approvals were not obtained prior to the receipt of the invoiced goods and services.
- Some personal service contracts that we reviewed lacked a detailed scope of measurable and verifiable services or deliverables. In addition, the personal service agreements, purchase orders, and invoices that we reviewed did not detail rates (e.g., one manager at \$100 per hour, one senior staff at \$60 per hour, etc.) and hours for services that were provided. As a result, there is a lack of assurance that the charges for the services were fair and reasonable.
- There was no expiration date on the accounting/consultant, public relations, or information technology consulting purchase orders.
- The DPL Purchasing Department procured fixed assets, tagged them, and was responsible for the annual inventory (segregation of duties issue). Personnel procuring fixed assets should not tag them and account for them in an inventory. This is too much control for one person and could result in fraudulent payments or theft.
- A former DPL Head Accountant circumvented the DPL purchasing procedures by purchasing office furniture for \$775 and then submitting reimbursement requests for \$400 and \$375 from the imprest cash account. The former Head Accountant should have obtained the proper approvals and a purchase order from the DPL Purchasing Department to procure the office furniture.

### **Disbursements**

- Disbursements for flood and fire damage repairs and personal services such as public relations and accounting/consulting were questionable because of the lack of: (1) competitive bidding; (2) detailed contracts specifying fees to be charged and services and hours to be provided; (3) proper contract monitoring; (4) segregation of duties for procurement and disbursement; and (5) support for invoices such as detailed time records.
- Some of the invoices for public relations services were approved for payment in advance of the services being rendered (e.g., March 1, 2000 invoice approved January 28, 2000).
- Some significant contract increases were approved by the Detroit Library Commission and some significant contract overruns were allowed to occur, in the

absence of internal controls related to contract monitoring, contract amendments, and contract renewals.

- A. A total of \$277,039 was paid to the public relations firm for the period January 28, 2000 to April 15, 2002. According to the minutes of the Detroit Library Commission, a total amount of \$275,000 was authorized for the public relations firm's services. The initial purchase order for public relations was not to exceed \$75,000.
  - B. Per the DPL records, a total of \$878,925 was paid to the accounting firm for the period December 21, 1998 to April 18, 2002 and appears excessive and questionable based on our observation of internal control weaknesses and other accounting deficiencies. According to the minutes of the Detroit Library Commission, a total amount of \$335,000 was authorized for the accounting firm's services. The initial purchase order for the accounting firm to conduct an operational review was not to exceed \$35,000.
  - C. A total of \$2,612,204 was paid to the information technology consultant for the period August 31, 1999 to May 12, 2002. According to the minutes of the Detroit Library Commission, a total amount of \$1,550,000 was authorized for the information technology consultant's services. The initial purchase order for information technology services was not to exceed \$275,000.
- According to a DPL representative, consulting services for information technology was not properly monitored to ensure that billed services were actually received and properly charged.
  - Several duplicate payments were issued to vendors (e.g., payment to public relations firm as detailed in Finding #3). The DPL management has not instituted adequate internal controls to detect duplicate payments, and the employees were not aware of some duplicate payment errors.
  - Some invoices were addressed to persons who initiated procurements, monitored contracts, and approved payments (segregation of duties issue). Invoices should be addressed to the DPL Business Office, Accounts Payable Division.
  - Invoices were not always stamped, or otherwise marked by DPL personnel to acknowledge receipt of goods and services, approve payments, and cancel paid invoices.
  - Some check stubs (from bank account checkbooks) which document the date, vendor, and amount paid; and some voided checks were not provided as requested by us and may be unaccounted for. Lack of control over checks could result in fraudulent payments.
  - The DPL Head Accountant wrote checks for non-City accounts, made bank deposits, and performed bank reconciliations. The Head Accountant also had signature authority over the DPL bank accounts. This was too much control for one person as a fraud could be committed by taking receipts or making inappropriate payments and covering them up.

### **Flood and Fire Related Losses**

- The DPL did not seek a competitive bid for the flood and fire damage repairs and did not have a written contract for the work. Flood and fire damage repairs were done without any agreed upon fee arrangements prior to the commencement of the work, such as fees to be paid to the General contractor for project management services and an allowable mark-up on goods purchased and subcontracted services. There was no documentation evidencing cost controls such as hours of work estimates by job classification, types of repairs needed, and fees or rates to pay workers.
- Cost estimates were not obtained immediately. The earliest initial estimate documented that we observed for the flood repairs was \$5.4 million dated September 18, 2000, over 50 days from July 28, 2000, the date of the flood damage. Cost estimates for emergency repair work should be obtained immediately to properly plan and control purchases and disbursements.
- The General contractor for the flood and fire damage repairs marked-up all purchased goods and subcontracted service invoices 40% (a reasonable markup is generally 5-20%) over cost, giving the general contractor approximately \$5.3 million on the \$18.7 million invoiced to the DPL. In addition, the major subcontractor for the flood and fire damage repairs marked-up all its purchased goods and subcontracted service invoices 21% over cost. Both the general contractor and the main subcontractor charged project management fees in addition to these mark-ups.
- The flood and fire damage repair invoices were not documented by DPL personnel to acknowledge receipt of goods and services, approval for payment, and cancellation of invoices after payment.
- Rare books were stored in the DPL basement and were damaged by the flood while at the same time the special rare book room, which was not affected by the flood or fire, was used to store computers.
- A DPL memorandum noted that the DPL still has inadequate sewer capacity and flood damage could occur again.

### **Recommendations**

We recommend that law enforcement officials investigate the payments to the flood and fire damage repair general contractor to determine whether any financial improprieties occurred.

In addition, we recommend that the DPL:

1. Take steps to improve its system of internal controls over procurements and disbursements. The DPL should adopt the City procurement and disbursement requirements. The City should provide the DPL with access to the Oracle Purchasing module. Competitive bids should be required and sought for all major contracts. Contracts should be drafted for all major purchases and include detailed specifications for services to be delivered and fees to be paid. The contracts should specify not to exceed amounts and expiration dates. The DPL should ensure a legal review of all major contracts.

2. Segregate procurement, receiving, monitoring, disbursement, and accounting duties, to the extent practicable. The employees responsible for purchasing activities should not have any responsibilities for receiving, monitoring, and approving payments. The DPL should require, in contracts and purchase orders, that vendors send invoices directly to the DPL Business Office, Accounts Payable Division.
3. Adopt effective receiving and monitoring practices to ensure goods and services invoiced were properly received and billed in accordance with the contract.
4. Adopt an emergency procurement plan to handle events like the flood and fire damage. Such a plan should: (1) anticipate each type of possible emergency; (2) include procedures for selecting contractors; (3) require that initial cost estimates be obtained as soon as possible; (4) require that a determination be made of services to be performed; (5) require establishment of pricing, fees and rates to include allowable mark-up on purchased goods and subcontracted services prior to the commencement of work; (6) include procedures for monitoring contractor performance; and (7) require an initial short term contract be obtained and properly approved.
5. Make the necessary infrastructure repairs to reduce the likelihood of flooding from backed-up sewers in the future.

### **3. Duplicate Payments Made**

#### **Allegation**

The former DPL Associate Director of Business and Financial Operations alleged that a duplicate payment was made by the DPL. He stated that "Some vendors are personal friends of the Director [name omitted]. One such vendor is [name omitted]. [name omitted] is a public relations firm. There was one instance where [name omitted] was paid once from the automated system [City accounting system] and then again from the so-called "Gift-Checking" account for the same service. The amount of the payments was \$25,000. The Gift-Checking account is an off-book account."

#### **OAG Conclusion**

The DPL did pay the public relations firm a duplicate payment of \$25,000 on January 28, 2000 from the Gift checking account. We also found duplicate payments to two other vendors. The former DPL Director did recover the duplicate payment from the public relations firm by extending the contract another month (April 2000) with the duplicate payment credited for the additional services by the public relations firm. As of July 25, 2002, the two other vendors have not returned the duplicate payments.

The manner in which the former DPL Director recovered the duplicate payment from the public relations firm is questionable because the DPL purchasing and disbursement internal controls were circumvented. As a result, there is a lack of assurance that the public relations firm's services for April 2000 were necessary and worth \$25,000 to the DPL. The questionable practices and other concerns raised by the recovery of the duplicate payment are detailed below.

- There was no documentation of approval by the Detroit Library Commission to extend the public relations firm's contract through April 2000 and pay the additional \$25,000. The original agreement authorized by the Detroit Library Commission was for public relations services for one year not to exceed the amount of \$75,000. An agreement letter dated January 4, 2000 from the public relations firm had a signature line for the former DPL Director, but was unsigned. The letter stated that the public relations firm will charge a non-profit discount fee of \$75,000 to be paid in three monthly installments of \$25,000 per month beginning January 5, 2000, February 5, 2000, and March 5, 2000 for public relations services beginning January 5, 2000, and ending March 31, 2000. The Detroit Library Commission did approve a continuing contract resolution on June 27, 2000 to continue the public relations firm's agreement through the fiscal year beginning July 2000 (fiscal year 2000-2001) for an additional \$50,000. A total of \$36,000 was paid to the public relations firm for fiscal year 2000-2001. As of June 30, 2001, the DPL had paid the public relations firm a total of \$136,000 exceeding the total amount of \$125,000 approved by the Detroit Library Commission.
- There was no documentation available of any formal approval by the former Director of the DPL or any other DPL official to extend the contract through April 2000 and pay the public relations firm the additional \$25,000. The only documentation was a letter from the President of the public relations firm dated March 10, 2000, stating that the firm continues to perform public relations and marketing services for the Detroit Public Library system through April 30, 2000 per the former DPL Director's discussion with the head of the public relations firm's team assigned to the DPL. The letter also acknowledged fee payment in full through April 30, 2000, as the DPL had paid \$100,000 to the public relations firm by March 10, 2000. The current Associate Director of Business and Financial Operations provided us with copies of the public relations firm's activities reports from the DPL Deputy Director's files which documented services were provided in April 2000.
- There was no documentary evidence available to support that the public relations firm's invoice dated April 1, 2000, for the additional work was processed through the DPL Business Office and it appears that the Business Office staff was unaware that the payment had been recovered. The DPL did not have a copy of the public relations firm's April 1, 2000 invoice in its files. The current Associate Director of Business and Financial Operations was provided a copy of the invoice from the public relations firm on July 11, 2002 when he attempted to collect the \$25,000 duplicate payment.
- The unsigned agreement letter, dated January 4, 2000, scope of services section, provided that the public relations firm would conduct an audit of the DPL Marketing Department. In addition, each of the first four \$25,000 invoices reference that the professional fees charged are in part for an audit of the DPL Marketing Department. It appears that an audit of the DPL Marketing Department was not done as the public relations firm's activities reports for the period January 2000 through April 2000 do not document that an audit was done.

In our opinion, the conditions and questionable circumstances surrounding the duplicate payment to the public relations firm are the result of:

1. A control environment wherein the authority and power of the DPL management was sufficient to circumvent the existing system of internal controls;
2. A "tone at the top" which did not reflect internal control consciousness; and
3. The system of internal control procedures was not sufficient to prevent, deter, or detect certain errors or irregularities such as a duplicate payment.

### **Background**

The public relations firm received many payments through the City from the DPL, but we could only find one payment made from a DPL controlled account. The DPL is authorized to approve and make payments subject to any gift restrictions from gift funds. As noted in the first finding, the Auditor General in 1964 recommended that the Gift funds be deposited with the City and expenditures from the fund be appropriated by the City Council. However, the DPL did not adopt this recommendation and continued to maintain the Gift funds in an account controlled by the DPL.

The DPL is responsible for establishing an adequate system of internal controls to ensure duplicate payments and other inappropriate payments are not made.

### **Internal Controls and Other Issues**

We noted the following internal control weaknesses and other issues concerning duplicate payments and personal service contracts:

- The former DPL Director awarded the contract for public relations, accounting, and information technology services without soliciting competitive bids. The former DPL Director controlled the selection and contracting processes for these services. The DPL Purchasing Department was not involved in the procurement of the public relations, accounting, and information technology services.
- The DPL purchase order with the public relations firm and other personal service contractors such as the accounting firm lacked a detailed fee arrangement specifying rates (e.g., one manager at \$100 per hour, one senior staff at \$60 per hour, etc.) to be charged and hours to be worked. As a result, there is a lack of assurance that the charges for the services were fair and reasonable.
- There was no termination date on the public relations, accounting and information technology purchase orders.
- The first three public relations firm's invoices were processed in advance of services being provided. Three of the public relations firm's invoices dated January 4, 2000, February 1, 2000 and March 1, 2000 respectively, each for \$25,000, were approved by the Director on January 28, 2000 and were processed for payment through the City's accounting system and were paid in February (\$50,000 total) and March (\$25,000) 2000 by the City.
- A check (i.e., duplicate payment) dated January 28, 2000, for \$25,000 was issued from the gift checking account (DPL controlled account) to the public relations firm for the invoice dated January 4, 2000. All of the payments to the public relations firm were made from the DPL City account and reported in DRMS with the exception of the \$25,000 duplicate payment made from the gift checking account. The duplicate payment was not reported on the purchase order payment control log with the other payments.

- The start date for the public relations firm services per the purchase order was January 28, 2000, although the unsigned agreement and first invoice were dated January 4, 2000. In addition, the public relations firm's January 2000 activities report for the DPL documented that services began on January 4, 2000.
- A conflict of interest was created by the former DPL Director's involvement in each aspect of the public relations firm's contract (purchase order) and payments, i.e., (1) initiated the contract; (2) monitored performance under the contract; (3) received invoices (invoices were addressed to the former DPL Director); (4) approved invoice payments; and (5) forwarded several check payments to the public relations firm from the Director's office.
- The former DPL Director was reimbursed \$168 for a luncheon with the public relations firm's representative on April 19, 2000. In our opinion, this expenditure is excessive and questionable.
- The DPL terminated the contract with the public relations firm in April 2002 and started a new public relations contract with a company owned by the former representative of the DPL account for the public relations firm.
- A total of \$277,039 including the duplicate payment was paid to the public relations firm by the DPL for the period 12/21/99 to 4/1/02. According to the minutes of the Detroit Library Commission, a total amount of \$275,000 was authorized for the public relations firm's services. The original purchase order was not to exceed \$75,000.
- We found two other duplicate payments. A vendor received a \$6,750 duplicate payment for making a video for the Roland Hayes Concert sponsored by the DPL. A florist received a \$290 duplicate payment for providing flowers to the opening the DPL coffee shop.
- The DPL maintains two accounting systems and too many bank accounts, which increase the risk for duplicate payments and fraud.
- The DPL does not always stamp or document (cancel) that an invoice has been paid. As a result, the risk for duplicate payments is increased.

### **Recommendation**

We recommend that the DPL collect the duplicate payments from the vendors. Also, we recommend the DPL management take actions to build a control conscious culture within the DPL accounting system. Management is responsible for establishing and modifying, as necessary, the system of internal controls. All employees, including management employees, are responsible for complying with the system of internal controls.

## **4. Questionable Transactions Related To Former Director's Automobile**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations alleged that the DPL Director, "placed one of the Library's vehicles, a 1999 Chrysler 300, in his own name. He has the library pay for the insurance and the maintenance on the vehicle."

### **OAG Conclusion**

Although the former DPL Director was authorized an automobile provided by the DPL including insurance and related expenses paid for by the DPL, the purchase of the automobile in the name of the former Director and the subsequent transfer of the automobile to the Detroit Library Commission (DPL) and the discrepancies with the vehicle registration and Certificate of Title indicates possible improprieties including misappropriation of DPL funds and assets. In addition, there are tax consequences such as fines and penalties to the DPL and the former DPL Director for failure to report and pay income taxes including City of Detroit income taxes on the personal compensation (income) amount of the automobile.

We could not resolve some issues related to the vehicle allegation. An auditor is encouraged to carry out an examination with an attitude of healthy skepticism which seeks corroboration of explanations offered for matters that have aroused questions in his mind, particularly when those explanations come from persons who could have personal reasons for diverting further inquiry. Therefore, we question the circumstances and events involving the vehicle purchase, transfer, Certificate of Title, and registration as detailed below:

- The former DPL Director circumvented the DPL procurement internal controls to purchase the 1999 Chrysler 300M automobile. The DPL Purchasing Department was not involved in the procurement of the former Director's automobile and told us that they had no knowledge of it. The DPL could not provide us with any documentation of the purchase other than a "Statement of Vehicle Sale", dated January 31, 2000, that documented the former Director as the purchaser and applicant for the Michigan Certificate of Title and registration. Neither the DPL nor any secured interest was listed on the "Statement of Vehicle Sale". There was no documentation in the Detroit Library Commission monthly meeting minutes of the Commissioner's approval for the purchase of the automobile. The available documentation indicates that the 1999 Chrysler 300M automobile was the personal property of the former DPL Director prior to May 2001.
- The DPL general ledger documents a check issued from the gift checking bank account to a consulting firm on February 2, 2000 for \$31,190.50, the same amount as the purchase price of the automobile. The DPL general ledger memo section documented that the payment was for consulting fees. The DPL could not provide us with a purchase order or invoice for this transaction. There was no documentation in the Detroit Library Commission monthly meeting minutes of the Commissioner's approval to contract with the consulting firm for \$31,190.50. The only documentation the DPL could provide us was the general ledger entry, cancelled check, and a vendor information request form. The vendor was listed in the yellow pages as an automotive consultant based in Grosse Pointe, Michigan. In our opinion, it is likely that the \$31,190.50 payment from the DPL to the consulting firm was for the purchase of the 1999 Chrysler 300M automobile by the former DPL Director. Further investigation by law enforcement officials is warranted to determine whether the former DPL Director misappropriated the \$31,190.50 to purchase the automobile.
- The Certificate of Title, dated May 22, 2001, for the 1999 Chrysler 300M automobile documented an ownership transfer to the Detroit Library Commission (DPL) in the month before the former DPL Associate Director of Business and Financial Operations made a representation to the IRS that the library director "had placed one of the Library's vehicles, a 1999 Chrysler 300, in his own name". The Certificate of



Title did not document the person (i.e., former DPL Director) transferring the automobile to the DPL. The DPL did not have a copy of the original Certificate of Title. In our opinion, it is likely that the former DPL Director was listed as the owner of the automobile in the original Certificate of Title. Further investigation by law enforcement officials is warranted because of the lack of available documentation regarding the vehicle transfer and the risk of impropriety.

- The Certificate of Title, dated May 22, 2001, for the 1999 Chrysler 300M automobile does not appear to be valid. In general, the seller or person transferring the automobile provides the vehicle mileage, selling date, and selling price information, and signs the title assignment. Similarly, the buyer completes the name and address information in the buyer's section of the title assignment, and signs the document. Alterations to a title (e.g., erasures) nullify the title and may result in civil liability, fines, and/or imprisonment. However, the Detroit Library Commission (buyer) and the seller or person transferring the automobile did not complete the section "Title Assignment by Seller" on the Certificate of Title for the 1999 Chrysler 300 automobile. Also, the records per an oil change document dated January 21, 2001 shows mileage of 19,645, whereas the title on May 22, 2001 shows an odometer reading of 12,000 miles. We concluded that further investigation by law enforcement officials is warranted regarding the Certificate of Title, since the copy may not represent a valid title.
- The vehicle registration copy provided to us by the DPL management for the 1999 Chrysler 300M automobile does not comply with the rules prescribed by the Michigan Department of State. A registration generally shows the license plate number and the corresponding vehicle identification number (VIN) for the license plate. However, the copy of the registration did not specify the corresponding vehicle identification number for the license plate. There was no information in the "vehicle number" data field on the registration form. The license plate number on the registration did not match the license plate number per oil change documents dated January and November 2001 for the automobile. Also, the information on the vehicle registration does not correspond to the information on the "Statement of Vehicle Sale" (Michigan Department of State Treasury Department, Form RD-108). The issuance date specified on the vehicle registration is November 3, 1999. However, according to the Statement of Vehicle Sale, the vehicle was delivered on January 31, 2000. We concluded that further investigation by law enforcement officials regarding the vehicle registration is warranted, since the copy may not represent a valid registration.
- The lack of an accident report included in the automobile database for the vehicle, although the vehicle was involved in an accident immediately before current library officials took possession of the vehicle.

The former DPL Associate Director of Business and Financial Operations statement, that the library director "placed one of the Library's vehicles, a 1999 Chrysler 300, in his own name", reflects the library ownership of the vehicle. However, supporting documents indicate that the vehicle was purchased by, and owned by, the former Director in the period preceding the May 2001 transfer of vehicle ownership to the Detroit Library Commission.

Documents show that the vehicle was not covered under a DPL insurance policy until June 2001. The former DPL Director had personally purchased insurance on the automobile prior to June 2001 and was reimbursed \$1,776 in August 2001 by the DPL for the period November 2000 through May 2001. The "Automobile Insurance Policy Renewal Declaration Certificate" documented that the former DPL Director was the principal driver and that the

rated usage was "pleasure, not driven to work or school", with annual mileage of 7,500 or less. The payments made by the DPL for maintenance and insurance were consistent with the benefits provision in the former Director's employment contract.

### **Background**

The library officials provided us with some information needed to address the issues related to employee compensation and vehicle purchase.

#### **Vehicle Component of Executive Compensation**

The terms and conditions of vehicle use were stated in the benefits clause of the former Director's employment contract, dated December 21, 1999. The employment contract includes the following provision, *"To facilitate the performance of [name omitted] responsibilities as director of a multi-facility system, the Library will provide an automobile designated by the Library. The Library shall satisfy all reasonable expenses related to the vehicle, including, but not limited to, the costs of maintenance, gasoline, repair, and insurance."*

#### **Vehicle Purchase**

According to the "Statement of Vehicle Sale" (Michigan Department of State Treasury Department Form RD-108) provided by the Acting DPL Director, the former DPL Director purchased the 1999 Chrysler 300M automobile from a dealer in Jackson (Michigan) on January 31, 2000 in his own name and not in the name of the DPL or Detroit Library Commission. The cost of the vehicle was \$31,190.50. There was no secured interest related to the vehicle since the vehicle was purchased for cash.

#### **Vehicle Title and Registration**

The DPL Acting Director provided us with copies of the Certificate of Title and registration. According to the DPL Acting Director, the Chrysler 300M automobile is currently in the possession of the DPL. The vehicle had been in the former DPL Director's possession until he resigned in March 2002.

### **Other Issues**

To obtain additional information regarding the vehicle, we purchased a vehicle history report from an outside vendor. The vendor history report included information on title checks, odometer rollback check, problem check, registration check, and vehicle history details. The vehicle report included the following information:

- The vehicle was registered as a private vehicle on February 9, 2000.
- The vehicle ownership was transferred on May 21, 2001 (The copy of the Certificate of Title that we were provided with was dated May 22, 2001).
- No accident record for the vehicle was found.
- The vehicle is currently registered as a private vehicle. The vehicle was not previously registered by a "not for profit" agency (non-profit registration) or public institution (government registration).

### **Recommendation**

Based on the foregoing unresolved issues concerning the vehicle, this matter should be investigated further by law enforcement and United States Internal Revenue Service officials.

## **5. Personal Service Contractors Not Provided Form 1099-MISC**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations alleged, "the Detroit Public Library pays personal service contractors from off-book accounts and from an imprest cash fund. These accounts are outside of the automated system that causes a Form 1099 to be issued to vendors. The Library does not manually issue Form 1099 to the vendors. Many of the vendors are Library employees who conduct performances for the branches of the Detroit Public Library. Other vendors do performances as well."

### **OAG Conclusion**

The DPL did issue Form 1099-MISC in 2000 and 2001 to personal service contractors. However, we did note that 6 (24%) of 25 personal service contractors requiring a Form 1099-MISC for 2001 disbursements from the DPL accounting system that we could identify were not provided a Form 1099-MISC. As a result, the DPL may be subject to fines and penalties from the Internal Revenue Service. In addition, income tax collections including those for the City of Detroit may be underpaid.

The DPL uses the Quick Books system to generate Form 1099-MISC for personal service contractors paid more than \$600 per year. The system requires that DPL check the system generator for a Form 1099-MISC when the vendor is established in the system. DPL did not always check the system generator for a Form 1099-MISC when it established the personal service vendor in the system. In addition, the DPL did not review the general ledger or checks paid to ensure that all personal service contractors received a Form 1099-MISC. As a result, a Form 1099-MISC was not provided to all vendors as required.

Also, we noted that not all checks were posted to the DPL general ledger, which could cause underreporting of the amount paid on the Form 1099-MISC or cause a Form 1099-MISC not to be generated if the total amount on the general ledger for the calendar year is less than \$600.

### **Background**

The DPL is responsible for ensuring the United States Internal Revenue Service requirements are followed. City purchasing procedures for personal services do not apply to the DPL. The DPL has the authority to enter into personal service contracts and approve disbursements in accordance with the contract. The DPL is responsible for providing a Form 1099-MISC documenting the amount paid to those personal service contractors paid \$600 or more per calendar year.

### **Recommendation**

We recommend that the DPL adopt procedures to ensure all payments and transactions are recorded on the general ledger. In addition, we recommend that the DPL implement procedures to ensure that all personal service contractors and others requiring Form 1099-MISC receive them and that they include the correct amount paid.

## **6. Computers Missing**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations made the following allegations regarding missing personal computers:

- "Another problem is that library officials in charge of buying items for the libraries are also in charge of storing and keeping track of them. This is a conflict of interest and a violation of legal accounting standards, because it leaves the library inventory open to theft."
- "As many as three-fifths of the computers that were ordered were never delivered to the branches or departments after they came to the Main Library".
- "When I came on board, my staff told me that computers were missing."

### **OAG Conclusion**

Not all the personal computers purchased by the DPL are accounted for. We noted the following:

<b><u>Model Number</u></b>	<b><u>Quantity Purchased</u></b>	<b><u>Quantity Per GASB 34 Inventory</u></b>	<b><u>Quantity Per DPL Records</u></b>	<b><u>Number (%) Unaccounted Computers</u></b>
Gateway E3200	299	256	237	43 (14.4%)
Gateway E4200	166	150	141	16 (9.6%)

The personal computer model number E3200 costs \$1,450 each and the total cost for the 43 unaccounted computers is \$62,350. The personal computer model E4200 costs \$2,054 each and the total cost for the 16 unaccounted computers is \$32,864.

The DPL internal controls for fixed assets were poor at the time most of the computers were purchased, especially for recording the transfer of personal computers from the initial receiving location. The DPL lacked a complete record of who took the personal computers from the initial receiving location and who ultimately received the personal computers. In addition, the DPL did not maintain a complete list of all personal computers with pertinent information such as tag number, serial number, and location. Also, the DPL failed to conduct annual independent physical inventories of personal computers and reconcile the physical inventories to the purchasing documents and personal computer records that should have been maintained. As a result, many of the personal computers are unaccounted for.

The current DPL administration has implemented controls to account for personal computers. However, there are additional controls needed and a complete physical inventory and accounting for all personal computers as described below.

### **Background**

The DPL is responsible for establishing adequate internal controls to safeguard fixed assets. Adequate internal controls include: (1) segregating duties where the person procuring fixed assets does not receive and account for them (i.e., performing a fixed asset

physical inventory); (2) properly tagging fixed assets, upon receipt, with the DPL property identification label and number; (3) recording all transfers of fixed assets to include names of accountable persons transferring and receiving them; (4) assigning department and branch library managers responsibility for all fixed assets in their department or branch; (5) maintaining an accurate subsidiary ledger of fixed assets with pertinent information such as tag number, serial number, and location, that is reconciled to the general ledger at the fiscal year end; (6) performing an annual independent physical inventory of fixed assets; (7) reconciling the annual physical fixed asset inventory with the subsidiary ledger and investigating any variances or discrepancies found; and (8) holding the responsible department and branch library managers accountable for variances and discrepancies found.

We compared purchasing records for the DPL computers to the City of Detroit Finance Department physical inventory records, dated March 18, 2002, of the DPL capital assets including personal computers. The Finance Department performed physical inventories of capital assets for all City Departments and entities that are reported in the City's Comprehensive Annual Financial Report (CAFR), which includes the DPL, to meet the GASB (Government Accounting Standards Board) 34 financial statement reporting requirements, which will require the reporting of capital assets for government entities beginning with the fiscal year ending June 30, 2002. Although we found errors with the City of Detroit Finance Department physical inventory records, such as incorrect serial numbers, missing serial numbers, incorrect model numbers, and duplication of items, we believe that it fairly represents the number of computers actually remaining at the DPL. In addition, we compared the purchasing records for the DPL personal computers to the personal computer inventory records maintained by the DPL Information Technology Department. The DPL Information Technology Department's inventory was incomplete and some errors were made, but it provided us with another source of information on the DPL computers for comparison purposes with purchasing records.

### **Internal Controls**

We noted the following internal control weaknesses and other issues concerning fixed assets:

- DPL lacked proper segregation of duties for procurement and control of fixed assets, as Purchasing Department personnel procured the computers, tagged the computers with the property identification labels, and were responsible for the annual fixed asset inventory.
- The DPL did not document the transfer of all the computers from the receiving location to the final user location. Transfers are now being documented. However, a DPL representative told us that some transfers may still go unreported.
- The DPL lacked an accurate independent inventory of all fixed assets on June 30, 2001. As of this report date (July 2002), the DPL lacks a complete listing of all the DPL personal computers.
- The DPL branch Library and Department managers were not assigned responsibility for fixed assets under their jurisdiction.
- The DPL property identification tag numbers were not documented for all computers on the DPL Information Technology Department's physical inventory list or on the City of Detroit Finance Department's physical inventory list for the DPL.

- We selected a sample of 183 personal computers from the DPL purchase orders and other DPL fixed asset records and could not find 9 (4.9%) of them on the City of Detroit Finance Department's physical inventory records for the DPL or on the DPL Information Technology Department's physical inventory records. It appeared that most of the personal computers that the DPL Purchasing Department was able to tag and record upon receipt were accounted for.
- There was a lack of accounting for old computers that were replaced or new computers that were returned (e.g., returned computers are not documented on the invoice or on the purchase order) to the vendor.
- The information technology consulting services were not properly monitored to ensure that billed services were actually received and properly charged.

### **Recommendation**

We recommend further investigation of the missing computers by law enforcement officials to determine whether any impropriety occurred. In addition, we recommend that the DPL conduct a complete fixed asset physical inventory by personnel independent of the Purchasing Department and Information Technology Department and account for all personal computers.

Also, we recommend that the DPL ensure that the system of fixed asset internal controls include: (1) segregating duties where the person procuring fixed assets does not receive and account for them (i.e., performing a fixed asset physical inventory); (2) properly tagging fixed assets, upon receipt, with the DPL property identification label and number; (3) recording all transfers of fixed assets to include names of accountable persons transferring and receiving them; (4) assigning department and branch library managers responsibility for all fixed assets in their department or branch; (5) maintaining an accurate subsidiary ledger of fixed assets with pertinent information such as tag number, serial number, and location, that is reconciled to the general ledger at the fiscal year end; (6) performing an annual independent physical inventory of fixed assets; (7) reconciling the annual physical fixed asset inventory with the subsidiary ledger and investigating any variances or discrepancies found; and (8) holding the responsible department and branch library managers accountable for variances and discrepancies found.

The Purchasing Department should not have responsibility for affixing DPL property identification tags, nor for performing the annual fixed asset physical inventory, as this should be the responsibility of a DPL department independent of the purchasing and accountability for the fixed assets.

## **7. Funds Not Spent in Accordance with Restrictive Agreements**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations made the following allegations regarding funds not spent in accordance with restrictive agreements by the DPL:

- "An additional consequence of hiding the grant money is that it can be used for purposes other than those stipulated by grant agreements."

- "(Library officials) did whatever they wanted to do with these grants."
- "Library records show over \$100,000 in expenditures that were not in keeping with the original Burton agreement."

### **OAG Conclusion**

The DPL did use restricted funds for purposes other than those stipulated by the restrictive agreements. In addition, other funds received from grants, gifts and endowments have not been spent and are accumulating in the DPL controlled bank accounts. The DPL reimbursed the Burton fund \$86,927 on February 13, 2002 for the purchase of rare books, which violated the Burton agreement with the DPL. We noted the following concerns with restricted grant, gift, and endowment funds provided to the DPL:

- The \$10,000 Poskel gift received on March 9, 1999 was not spent. The Poskel gift is to be applied towards enhancements for the services for shut-ins and retirees at the Fredrick Douglas Branch for Specialized Services.
- The Walus (\$23,715 available at June 30, 2001) and Ulveling/MacCrone (\$35,960 available at June 30, 2001) trusts' income were not spent since January 31, 1996 and January 7, 2000 respectively. The Walus investment income is to be used to purchase books or printed matter in the English language on subjects pertaining to Poland or the Polish American segment of our society. Proceeds from the MacCrone Trust are credited to the Ralph Ulveling Fund to benefit the DPL.
- The O'Brien trust fund (\$2,554,819 market value at March 31, 2002) has grown significantly over the years because the Detroit Library Commission restricted distributions to funding only DPL employee travel and training with investment income (\$24,106 reported for fiscal year 2001) from the trust. The O'Brien trust fund is under the full control of the DPL. The DPL administration with the Detroit Library Commission's approval can utilize the entire trust amount, or any portion thereof, for any educational and charitable purposes whenever it chooses to do so.
- Income from the Biddle and McGraw endowment funds to benefit the Wayne State Library were not disbursed during the period December 1993 to January 2002. In January 2002 the DPL did transfer the funds due the Wayne State Library (\$25,198 - Biddle and \$12,490 - McGraw).
- Funds were accumulating in the other DPL accounts and not being utilized to support the DPL. There was \$116,396 in the Gift Checking account with the First Independence Bank and \$805,406 (market value) in the Gift Trust account at June 30, 2001 that could be utilized to support DPL operations. The DPL accounting system general ledger reported revenues exceeded expenses by \$638,000 in fiscal year 2001 further adding to the growing bank balances.
- The DPL lacked budgets and planning for spending funds from gifts, grants, and endowments. As noted in Finding 1, the DPL lacked good accounting and financial management to determine the amount of funds available for operations. For example, not all investment income was posted to the DPL general ledger. Consequently, the DPL management did not know how much investment income was available to support its operations.

The DPL discourages businesses and individuals from providing grants, gifts, and endowments when existing funds are not properly managed and spent in accordance with the restrictive agreements. In addition, the DPL is shortchanging Library services provided to the public by not expending funds and allowing them to accumulate. Also, there is an increased risk that idle funds could be misappropriated.

### **Background**

The DPL receives grants, gifts and income from endowments that may have restrictive agreements specifying how the funds can be spent. We identified six endowment accounts totaling \$5.1 million that provide the DPL with investment income and are restricted for specific purposes. Also, we identified several gifts that had specific restrictions. In addition, the DPL was awarded a \$5.0 million grant from the Skillman foundation to be used exclusively to renovate the Downtown Library Branch. As noted in the previous finding, the DPL received grant funds to purchase personal computers. The DPL is responsible for ensuring that restricted funds are spent in accordance with the agreements.

### **Recommendation**

We recommend that the DPL adopt the recommendations in the first two findings and improve its internal controls and financial management. In addition, we recommend that the DPL create a plan for utilizing grants, gifts, and endowments in accordance with the restrictive agreements. The DPL needs to establish controls to monitor the receipt and expenditure of grant, gift and endowment funds. Funds should not be allowed to accumulate with no express purpose.

Also, we recommend that the DPL review the current restrictive agreements such as the Burton Fund agreement and determine whether any funds were misspent, and reimburse the restricted funds for any misspent funds.

## **8. Special Event Revenue Not Properly Accounted For**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations alleged improper accounting for special events held at the DPL by stating, "In past years, Library facilities was used to host an event known as "Holiday Dinner". The event was promoted using Library funds. The Library incurred the costs for the event. Tickets were sold to the public for attendance at the event. Unlike the grants, the revenues from this event were not only not reported in the financial statements of the Detroit Public Library but the proceeds from the ticket sales were not turned over to the control of the Business and Financial operations function. Recently, the Detroit Public Library hosted a concert at the Detroit opera House. This concert was in honor of the late opera singer, Roland Hayes. The Library incurred all of the costs related to the giving of the concert to include the promoting of the concert, the rental of the opera house, and the payment of the performers. The proceeds from the sale of tickets for this event were not turned over to the Business and Financial Operations function of the Detroit Public Library."



### **OAG Conclusion**

The DPL did account for special event revenue from the Holiday Dinner in December 2000 and the Roland Hayes Concert in March 2001 in the DPL accounting system general ledger. The Michigan Opera Theatre collected the ticket revenue for the Roland Hayes Concert and remitted the net proceeds to the DPL. In addition, the DPL did report revenues from a Garage Sale held in July 2000 in the City DRMS system and deposited the revenues in the City bank account for DPL.

The DPL cannot account for all the cash receipts from the special events in fiscal year 2001 and some may be misappropriated. A total of \$6,348.25 in cash receipts for the December 2000 Holiday Dinner appear to be missing, as the bank reconciliations for the Gift checking account document them as uncleared deposits for over 11 months. The DPL could not provide us with copies of the pre-numbered receipts documenting the revenue collections for the Garage Sale and Holiday Dinner. As a result, we could not determine whether all cash receipts from these special events were properly accounted for.

The Roland Hayes Concert was a costly extravaganza that did not raise the funds to process the Roland Hayes Collection, as was intended. The Library lost at least \$79,730 (\$119,740 expenses identified including a \$6,750 duplicate payment less \$40,010 revenues) on the Roland Hayes Concert. The Detroit Library Commission authorized funds not to exceed \$50,000 for the Roland Hayes Concert and related activities.

### **Background**

As part of good internal controls, the DPL is responsible for establishing adequate internal controls over special events. Special events should be planned and have a budget to control costs. Goals should be established for what the special event is to accomplish. After the event, a revenue and expense analysis should be prepared to determine the cost and benefits provided.

### **Internal Control Weaknesses and Other Concerns**

We noted the following DPL accounting system internal control weaknesses and other concerns for DPL special events:

- The DPL did not specifically account for special events such as preparing a cost-benefit analysis for the event. In addition, the DPL did not prepare a budget or financial plan for special events.
- We could not identify all the expenses associated with the Roland Hayes Concert and Holiday Dinner because not all the expenses were posted to the general ledger and those posted did not always show the purpose of the expense. We identified four different bank accounts used to pay expenses for the Roland Hayes Concert.
- The Friends of the Detroit Public Library cancelled support for the 2001 Holiday Dinner because the DPL could not provide an accounting for the 2000 Holiday Dinner and show whether the event was profitable in raising funds to support Project Mainstreet.
- The DPL did not account for all prenumbered cash receipts to ensure that all revenues are received and properly deposited.

### **Recommendation**

We recommend that the DPL establish adequate controls over special events to include planning and budgeting. Goals should be established for the event (e.g., the Holiday

Dinner will provide \$50,000 after expenses for Project Mainstreet). In addition, we recommend that a specific accounting be done of all revenues and expenses for the event. Post event comparisons should be made with plans and budgets to properly assess the event.

## **9. Inadequate Accounting for Donations from the Friends of the DPL**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations alleged inadequate accounting for donations from the Friends of the Detroit Public Library by stating, "The Branch Services Division and other functions of the Library asserted independence with respect to the financial matter of receiving monies directly from one grantor. That grantor, Friends of the Detroit Public Library, Inc., which is housed on the premises of the Detroit Public Library made direct grants to Managers of the Branches of the Detroit Public Library. The Friends of the Detroit Public Library, inc. is recognized as a charitable, tax-exempt organization under Section 501c(3) of the Internal Revenue Code. I demanded that the Business and Financial Operations function be advised of any in-kind gift made to any element of the Detroit Public library. I also demanded that all monetary awards, gifts, or grants be delivered to the Business office of the Detroit Public Library. I indicated that this meant that the awards, gifts, or grants be made in the name of the Detroit Public Library. I further indicated that an award, gift, or grant may be restricted to a particular use or purpose. The Friends of the Detroit Public Library, inc. refused to comply with this demand. [name omitted], the Associate Director of Branch Services of the Detroit Public Library, repeatedly asserted that the money received by Managers of the Branches of the Detroit Public Library was none of my business. The Executive Administration of the Detroit Public Library endorsed this position. The Executive Administration also received money directly. Managers of the functions and operations housed in the Main Library also received money directly. This money included funds for travel."

### **OAG Conclusion**

The branch Library managers' check requests for payments to vendors did not go through the DPL Business Office prior to submission to the Friends of the Detroit Public Library. The Assistant Director of Branch Services approved the check requests and forwarded them to the Friends of the Detroit Public Library. As a result, the DPL Business Office and DPL management were unaware of payments made by the Friends of the Detroit Public Library directly to vendors in support of the branch libraries. Some of the checks were to reimburse DPL employees for expenses and pay DPL employees for entertainment performances provided for branch Library programs to the public.

We did not observe any direct grants from the Friends of the Detroit Public Library to any branch Library managers or other DPL managers in our investigation of the DPL and the Friends of the Detroit Public Library records. Currently, for most major program support, the Friends of the Detroit Public Library provides the DPL Business Office with checks made out to the Detroit Public Library with program name or purpose specified.

There is a need for the DPL to improve internal controls over funds provided by the Friends of the Detroit Public Library. Also, there is a need for the DPL and the Friends of the Detroit Public Library to eliminate duplication of efforts and improve fundraising to support the DPL.

### **Background**

The Friends of the Detroit Public Library is a non-profit, 501(C) (3) tax exempt, corporation organized to provide financial assistance to and, in general to further the interests of the Detroit Public Library. The Friends of the Detroit Public Library is governed by a board of directors. The Friends of the Detroit Public Library is independent of the City and the DPL.

The DPL is responsible for establishing a system of internal controls over funds provided by the Friends of the Detroit Public Library and the Branch Library Friends organizations in support of the DPL. The system of internal controls should include budgeting, planning, recording, summarizing, posting, and reporting.

### **The Friends of the Detroit Public Library Support to the DPL**

The Friends of the Detroit Public Library budget for fiscal year 2000-2001 (May 1, 2000 to April 30, 2001) was \$524,000, which included \$210,500 direct support to the DPL. For example, \$100,000 was provided for Library Security Systems and \$20,000 was provided for the summer reading program. The Friends of the Detroit Public Library presently provides a copy of the Budget to DPL management for the funds it will provide to the DPL.

The Friends of the Detroit Public Library reported actual expenses of \$670,251 for fiscal year 2000-2001. This included \$386,642 reported as support for the Detroit Public Library, \$185,836 management and general expenses, and \$97,773 for fundraising. The \$386,642 support for the Detroit Public Library consisted of \$16,250 for the National Automotive History Collection, \$254,621 for Library programs for children and adults, \$58,272 for support of Detroit Public Library Branches, and \$57,499 for Library administrative support and equipment.

The Friends of the Detroit Public Library budgeted \$4,000 in fiscal year 2000-2001 to provide the DPL Director and Deputy Director funds (DPL Director's Fund) for attending special functions. The amount of actual expenditures from the DPL Director's Fund was \$3,650 for costs associated with membership, training, travel, attendance at special events and other purposes for the period May 2000 to April 2001.

The Friends of the Detroit Public Library budgeted \$4,000 in fiscal year 2000-2001 to provide the DPL staff with goodwill, luncheons, hospitality, and food at conferences (DPL Staff Activities Fund). The amount of actual expenditures from the DPL Staff Activities fund was \$3,741 for the period May 2000 to April 2001.

The Executive Director of the Friends of the Detroit Public Library provided us with an unaudited Branch Library Friends Account Balances list, dated March 7, 2002, totaling \$127,000 in funds available for individual branch libraries (e.g., Lincoln Branch library \$13,734) and Main Library departments (e.g., Art & Literature \$1,749). These funds are provided by specific Branch Library Friends organizations, which are independent of the Friends of the Detroit Public Library. These funds are not included in the Friends of the Detroit Public Library budget. These funds can be expended for the branch libraries and departments after proper approval for check requests. For example, Branch Library managers submit check requests for approval to the Assistant Director of

Branch Services, who will forward approved check requests to the Friends of the Detroit Public Library for payment.

### **Internal Controls and Other Issues**

We noted the following internal control weaknesses over the funds provided by the Friends of the Detroit Public Library and other issues:

- There was a lack of a formal agreement/contract on organization responsibility and jurisdiction between the DPL and the Friends of the Detroit Public Library.
- There was a duplication of effort between the DPL and the Friends of the Detroit Public Library for fundraising, marketing, public relations, performer contracts, and administration services.
- The DPL lacked a plan for utilizing the funding support of the Friends of the Detroit Public Library.
- The DPL did not provide the Friends of the Detroit Public Library with a specific accounting for the funds received (e.g., revenue contributed, funds expended, and funds remaining). The DPL did not post the general ledger with all the contributions (\$8,000) made by the Friends of the Detroit Public Library in fiscal year 2000-2001.

There is a need for an agreement between the Friends of the Detroit Public Library and the DPL similar to the agreement between the Detroit Zoological Institute and Detroit Zoological Society. An agreement should clearly establish each organizations mission and responsibilities for the Main Library and Branch Libraries. In addition the agreement should include the following provisions:

- All Library operational activities (including the Friends of the Detroit Public Library activities) are subject to the overall control and approval of the Detroit Library Commission (i.e., DPL).
- The DPL and the City have the right to examine the Friends of the Detroit Public Library financial records.
- The amount of any salary supplements and other remuneration paid to DPL employees by the Friends of the Detroit Public Library will be disclosed.

The DPL and the Friends of the Detroit Public Library need to work together to eliminate any duplication of efforts and to improve the planning, utilization, and accounting of all funds provided by the Friends of the Detroit Public Library in support of the DPL.

### **Recommendation**

We recommend that the DPL:

- Improve the internal controls over funds provided by the Friends of the Detroit Public Library. The Business Office needs to receive documentation on all payments made in support of the Branch Libraries and the Main Library by the Friends of the DPL. There needs to be a specific accounting of funds received from the Friends of the Detroit Public Library to identify funds received, expended, and balances remaining by program.
- Enter into an agreement with the Friends of the Detroit Public Library to clearly establish the mission and responsibilities for both organizations. The DPL and the

Friends of the Detroit Public Library need to improve the fundraising for the DPL, especially for infrastructure improvements.

- Establish a five year plan for the utilization of the Friends of the Detroit Public Library funding and a capital campaign for infrastructure improvements.

## **10. Lack of Accountable Plan for Employee Travel**

### **Allegation**

The former DPL Associate Director of Business and Financial Operations made the following allegations regarding the lack of an accountable plan for employee travel:

- "I have attempted to get the Library to establish and comply with an accountable plan for the travel of its employees. The Library had been simply issuing sums of money from an off-book account to employees for travel. Employees claimed large sums of money for the purpose of travel, failed to reconcile the costs of their travel to the travel advance, and, of course, kept the residual from the travel advance."
- "I attempted to have the employees of the Library reconcile their travel. This was thwarted by the Executive Management. The Executive Management stated that the Library had adopted no travel policy. It also ignored entreaties to the Human Resources Division, that in the absence of a travel policy, that monies advanced for travel must be included in the income of the employee."
- "On or about May 1, 2001, I commenced paying travel only through an accountable plan of the City of Detroit. During the latter days of May, the Executive Administration has intervened by mandating that travel again be paid from the off-book O'Brien Endowment Fund. I am simply ignoring the mandate. The Executive Administration is endorsing the checks from this fund itself in support of travel by employees of the Detroit Public Library."

### **OAG Conclusion**

The DPL travel funds were issued outside of an accountable plan, as alleged. In the entrance conference preceding the independent investigation, the DPL management stated that the DPL did not have an accountable plan for travel of the DPL employees at the time of the allegations.

In general, at the time of the allegation, DPL employees received travel advances, in lieu of expenditure reimbursements for meals and other expenditures incurred during out-of-state travel. Although, the IRS regulations indicate that "if the reimbursements are not made under an accountable plan, the employer treats the reimbursements as part of the employees compensation", the DPL accountants did not include these travel allowance amounts in the employees income.

The DPL is now operating under an accountable plan for travel. The DPL adopted the Budget and Travel Policy of the City of Detroit in 2001. The City's Travel Policy includes the following information, "The City has elected to use only the 'accountable plan' arrangement detailed in the IRS Publication 1542, 41 CFR, Chapter 301."

We noted the following issues related to travel payments:

1. Travel advances were provided for expenses that were paid or incurred by the former DPL Director, however it was unclear whether the charges were incurred in the course of DPL business or for personal purposes. For example, a transaction involved the former DPL Director's attendance at the American Library Association Midwinter Meeting in Washington, D.C. during the period from Friday, January 12, 2001 to Wednesday, January 17, 2001. A check drawn against a DPL checking account was used to pay for the former DPL Director's airline ticket. The check request specified that the check "was for [name omitted] airfare for the American Library Association's Midwinter Conference - Washington, D.C. - January 10-17, 2001." On Wednesday morning, January 10, 2001, the administrator traveled from Detroit, Michigan to Newark, New Jersey. On Thursday afternoon, January 11, 2001, the former DPL Director traveled from Newark, New Jersey to Washington, D.C. However, the voucher package did not include any documentation or references to a business purpose for the travel to Newark, New Jersey.

The former DPL Director also received a travel advance for lodging (7 nights), transit, and per diem (8 days) expenses. However, there was no documented business purpose associated with the lodging costs and per diem allowance for the pre-conference date, January 10, 2001.

On January 8, 2001, another check request for \$360 was processed for "additional expenses for [name omitted] trip to the ALA Midwinter Conference in Washington, D.C." The check request did not contain any additional details regarding the anticipated expenditures.

2. Some travel vouchers did not contain adequate documentation to substantiate the amount, time, use, and business purpose of the travel expenses. For example, a transaction involved reimbursement of expenditures incurred at a Teahouse, but the receipts did not include supporting documentation detailing the names of attendees, time of gathering, or business purpose. Another example was in January 2001, a check request was prepared to reimburse the former DPL Director for business expenses for food and a magazine. The supporting documentation provided with the receipts cannot be utilized to determine whether the transactions represent bona fide business expenditures incurred during travel on Library business. We noted many reimbursements to the former DPL Director for meals at local restaurants although a bona fide business purpose or travel related purpose was not documented.

## **Background**

### **Accountable and Non-accountable Plans**

Reimbursements for employee business expenses made under an accountable plan are tax deductible for the employer. The employer claims the deduction on the applicable tax forms and schedules. The business organization type (e.g., corporation or tax-exempt organization) is the determinant of which forms and schedules are filed. These expenses are excluded from the employees' gross income for payroll tax purposes.

The IRS defines an accountable plan as a reimbursement arrangement that meets the following three requirements:

1. The reimbursements must be for the employer's deductible business expenses that are paid or incurred by an employee in the course of performing services on behalf of the employer;
2. The employee must be required to substantiate the amount, time, use, and business purpose of the reimbursed expenses to the employer; and
3. The employee must be required to return to the employer any excess of reimbursements over substantiated expenses within a reasonable period of time.

The IRS defines a nonaccountable plan as a reimbursement or expense allowance agreement that does not meet one of the three requirements for an accountable plan. If the reimbursements are not made under an accountable plan, the employer treats the reimbursements as part of employees' compensation. The employer is required to include the reimbursements in the employees' wages on IRS Form W-2, and withhold income taxes on reimbursements made because the reimbursements are included in the employees' taxable wages. In addition, the business entity must pay the employer portion of the payroll taxes for the reimbursement amounts included in the employee's taxable income. The employee must generally claim a miscellaneous itemized deduction for the allowable business expenses to obtain a reduction in income taxes.

### **Recommendation**

We recommend that the DPL ensure that the requirements for an accountable plan for reimbursement of employee business expenses including documenting the business purpose are followed.

## **11. Other Financial Considerations**

- The Highland Park Library closed recently and this could cause the DPL to lose its Detroit Associated Library (DAL) funding (approximately \$500,000) from the State of Michigan. The DAL funding is contingent on an association of more than one library system and the DPL and Highland Park are the only members of the DAL. According to a DPL representative:
  1. The DPL has filed an amended "Plan of Service" with the Library of Michigan when the City of Highland Park closed its McGregor Public Library.
  2. The City of Highland Park intends to open a Library in an alternative location.
  3. The Board of Commissioners of Highland Park as well as the Detroit Library Commission are fully aware of the serious financial threats to Highland Park and are committed to the provision of reciprocal library services for Highland Park residents in Detroit.

- The DPL has lost State funding, over \$2.5 million, for fiscal year 2002-2003 due to budget cuts by the State. These cuts will require that the DPL be more fiscally responsible than it has been in the past. It will also necessitate close cooperation with the Friends of the Detroit Public Library to raise funds. The DPL has adjusted its fiscal year 2002-2003 budget to reflect the loss of State funding.